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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 937

ESTATE OF JOHN W. HERBERT, DECEASED, CENTRAL HANOVER BANK AND TRUST COMPANY, ET AL., EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 20a–21a) is not officially reported. The opinion of the Circuit Court of Appeals (R. 22–27) is reported at 139 F. 2d 756.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 30, 1943 (R. 28), and petition for rehearing was denied February 4, 1944

(R. 38). The petition for a writ of certiorari was filed on April 27, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The estate of the decedent acquired a claim from the decedent on which it realized amounts in cash and property in excess of the fair market value of the claim as of the date of the decedent's death. The question is whether this excess is taxable income to the estate.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set out in the Appendix, *infra*, pp. 11–13.

STATEMENT

The facts reflected by the stipulation of facts (R. 18a–19a), findings of the Tax Court (R. 20a) and the Commissioner's deficiency letter, attached as an exhibit to the petition for review by the Tax Court (R. 11a–17a), may be summarized as follows:

Petitioners are the executors of the estate of John W. Herbert, deceased. The decedent died on August 26, 1934, owning a claim against Peoples Realty Company, a New Jersey corporation, all of whose stock he held. The claim was in the face amount of $531,817.75 and was represented partly by notes and partly by an open account. (R. 19a.)

The fair market value of the claim on the date of death was $200,191.90. Petitioners collected $282,500 in cash from Peoples on account of the claim, of which $155,000 was collected by the end of 1937, $127,000 during 1938, and $500 during 1939. In addition, petitioners received interests in two mortgages in 1939 on account of the claim. The aggregate fair market value of these interests at the time of their transfer was $13,303.61 (R. 19a.)

In the 1938 and 1939 income tax returns filed by the executors of the estate of the decedent there were reported as capital gains amounts collected in 1938 and 1939 in excess of the fair market value of the claim at the date of the decedent's death (R. 14a, 16a). The Commissioner adjusted the returns by excluding these reported amounts as capital gain and by adding the total of the excess to ordinary income in the amount and year received (R. 12a–17a).

In the Tax Court petitioners contended that the excess was not taxable income and, in the alternative, that it was taxable only on a reduced basis as capital gain. The Tax Court rejected both contentions and affirmed the Commissioner's determination. (R. 20a–21a.) Petitioners abandoned the alternative contention on appeal to the Circuit Court of Appeals (Br. 16) and that court affirmed the decision of the Tax Court on the ground that the excess was taxable income (R. 22–28).

ARGUMENT

Section 161 (a) (3) of the Revenue Act of 1938 (Appendix, *infra*, pp. 12–13) provides that the income taxes imposed by the Act upon individuals shall apply to the income received by estates of deceased persons. The Act further provides that the basis for determining gain received by an estate from the sale "or other disposition of property" shall be the fair market value of such property at the time of its acquisition and that the recognized gain from the disposition of the property shall be the excess of the amount realized over the fair market value of the property at the time of its acquisition. Sections 22 (f), 111 (a) and (b), 113 (a) (5) and (b) (Appendix, *infra*, pp. 11–12). The Act therefore treats the estate of a decedent as a new and different taxpayer (opinion of the court below, R. 25) which, under Section 22 (a) (Appendix, *infra*, p. 11), is taxable on "gains * * * derived from any source whatever." Petitioners contend, however, that the estate realized no gain or income from the claim it acquired from the decedent (Br. 24–31) and that if it did realize a gain it was not through a "disposition" of property (Br. 14–24).

The argument that the amounts realized by the estate from the claim in excess of the fair market value of the claim at the time of the decedent's death were not gain, or income, rests on the premise that the estate of the decedent

should not be regarded as a taxpayer separate and distinct from the decedent. The premise is fallacious, for the Act treats the estate as a separate taxpayer, as we have shown, and this Court, noting that this treatment has been consistent in the various Revenue Acts, has held that the treatment of the estate as a separate taxpayer is proper. *Hartley* v. *Commissioner,* 295 U. S. 216; *Helvering* v. *Reynolds,* 313 U. S. 428; *Brewster* v. *Gage,* 280 U. S. 327. Thus, as the Court also held in the latter cases, it is proper to compute the gain to the estate on property acquired from the decedent on the basis of the fair market value of the property when the estate acquired it at the decedent's death. Any loss which previously accrued to the decedent between the date of his acquisition of the property and his death is not to be taken into account in computing the tax liability of the estate. *Hartley* v. *Commissioner, supra,* p. 219. The principle applies to claims existing at the date of death as well as to other forms of property. See *Helvering* v. *Roth,* 115 F. 2d 239 (C. C. A. 2d), where it was held that the estate realized income on a claim which had a zero basis on the date of death.

It is therefore inapposite that, as petitioners argue (Br. 29–31), the application of the statutory basis for determining gain to the estate may in effect amount to a write-off of a bad debt so

far as the decedent is concerned.[1] The total by which the amount realized by the estate exceeds the value of the property on the date of acquisition by the estate is an actual gain accruing to capital, or a growth or increment of value in the investment, so far as the estate is concerned. See *Hartley* v. *Commissioner, supra; Helvering* v. *Roth, supra; Blodget* v. *Commisioner,* 13 B. T. A. 1243; *Vanderbilt* v. *Commissioner,* 11 B. T. A. 291; 6 Mertens, Law of Federal Income Taxation, Section 36.25; cf. *Kenan* v. *Commissioner,* 114 F. 2d 217 (C. C. A. 2d); *Suisman* v. *Eaton,* 15 F. Supp. 113 (D. Conn.), affirmed, 83 F. 2d 1019 (C. C. A. 2d), certiorari denied, 299 U. S. 573. It follows that the decision below, holding that the gain to the estate is income, is correct and does not conflict with this Court's decision in *Eisner* v. *Macomber,* 252 U. S. 189, or with the cases cited by petitioners (Br. 6–7, 27–29) as holding that only actual gains are taxable.[2]

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[1] Contrary to petitioners' contention (Br. 30–31), this conclusion is not inconsistent with this Court's decision in *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231. In addition to the fact that that case does not *require* application of the tax benefit theory, it did not involve the application of the theory in connection with separate and distinct taxpayers. Manifestly, the lack of a tax benefit to one taxpayer for a loss on property does not change the nature of the gain on the property by another taxpayer.

[2] *Elmhirst* v. *United States*, 38 F. 2d 915 (C. Cls.), certiorari denied, 282 U. S. 851, is the only case relied upon by petitioners in this connection which involves the basis for de-

Nor is the statutory occasion for attributing gain to the estate inapplicable here, as petitioners contend (Br. 14–24), on the ground that there was no "sale or other disposition" of property within the meaning of Section 111 of the Act. As the court below held (R. 26–27), the relinquishment of the claim by the estate upon payment was a "disposition" of the claim in the elementary and usual sense of the word [3] and the legislative intent to tax gains resulting from such a disposition is clear.[4] *Helvering* v. *Roth, supra.* As pointed out by the court below, the term "disposition" is used in precisely that sense in Section 44 (d) of the Internal Revenue Code. One who purchased a chose in action and afterward collected more upon

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termining gain to an estate. The position taken in that case was based on *McKinney* v. *United States*, 62 C. Cls. 180, and was rejected by this Court in *Hartley* v. *Commissioner*, *supra*.

[3] The early decision in *United States* v. *Carter*, 19 F. 2d 121 (C. C. A. 5th), cited by and quoted from by petitioners (Br. 18–19), does not seem to be inconsistent with this conclusion. In that case the question was as to the value of a partnership interest of the deceased. The facts were such that the executors of his estate could not determine its value and were compelled to make an arbitrary guess for estate tax purposes. The court held that for income tax purposes the difference between the actual value, which later appeared, and the estimated value was not income. It appears that the court was speaking of actual value at the time of the decedent's death.

[4] The decision below is not in conflict with the decision in *First Sav. Bank of Ogden* v. *Burnet*, 53 F. 2d 919 (App. D. C.), in which it was stated that the rule of *ejusdem generis* should be applied in construing the phrase "sale or other

it than he paid, would certainly not escape taxation of the gain upon the theory that he had not made "disposition" of the claim. Petitioners' arguments in this connection that there was no "differential" basis for attributing gain (Br. 15, 22) and that the transaction was a restoration of possession of the money loaned by the decedent, instead of a disposition of the claim acquired by the estate (Br. 16–18), obviously have no merit.

It seems clear, too, that the gain realized by the estate is taxable under the Act regardless of whether the liquidation of the claim involved a disposition of property. Sections 22 (a) and 161 (a) (3) require the estate to pay income tax on gains from whatever source derived. As the Circuit Court of Appeals for the Second Circuit stated in *Helvering* v. *Roth, supra,* which involved the identical question presented in this case, the general intent of Section 22 (a) was to

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disposition" of property contained in Section 202 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227. That case involved a totally different issue, namely, whether the distribution by a bank to its stockholders of the stock it held in another corporation was a "disposition" of property which entitled the bank to take a loss in the amount of the difference between the cost to it of the stock and its market value at the time of distribution. The court resolved its doubt regarding the construction of the statute as applied to the particular facts by recourse to Treasury Regulations applicable to the analogous situation presented by the distribution of assets of a corporation upon its dissolution.

tax all realized gains and no reason appears for restricting its scope.

Section 113 (a) (5) of the Act provides, without reference to a sale or disposition of property, that the basis of property acquired by a decedent's estate shall be the fair market value of the property at the time of its acquisition, meaning acquisition by the estate at the time of the decedent's death. *Hartley* v. *Commissioner, supra.* Article 111–1 of Treasury Regulations 101 (Appendix, *infra,* p. 13), specifically provides that, even though property is not sold or otherwise disposed of, "gain (includible in gross income under section 22 (a) as 'gains or profits and income derived from any source whatever')" is realized if the sum of all the amounts received which are required by Section 113 (b) to be applied against the basis of the property exceeds such basis. It is significant that this regulation is identical with corresponding provisions of Article 111–1 of Treasury Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936, respectively, and that, in consequence, the clearly stated official interpretation of the applicable statutory provisions has had the confirmation of two re-enactments of the provisions. No reason appears for a changed interpretation now.

CONCLUSION

The case was correctly decided below and involves no conflict of decisions or important, unsettled question of law. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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MAY 1944.